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The Broad M&A Implications Of DOJ's Boozz Allen Challenge

By **Lisa Rumin, Jon Dubrow and Anthony Ferrara** (July 19, 2022, 3:41 PM EDT)

In late June, the Antitrust Division of the U.S. Department of Justice filed a complaint seeking to enjoin Booz Allen Hamilton Holding Corp's proposed acquisition of EverWatch Corp.[1]

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The complaint filed in the U.S. District Court for the District of Maryland focuses on the transaction's impact on one specific bidding opportunity to supply services to the National Security Agency.

Shortly thereafter, on July 8, the DOJ filed an emergency motion for preliminary injunction asking the court to abrogate the parties' merger agreement.

This case has several interesting features that illustrate unique aspects of aerospace and defense industry merger reviews, reflect the current DOJ's aggressive approach to merger enforcement and introduce new theories that could affect other transactions.

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Case Background

Booz Allen signed an agreement to acquire EverWatch, a small private equity-backed contractor, on March 15. The transaction was reportable under the Hart Scott Rodino, or HSR, Act. The DOJ alleges that the parties reached this agreement shortly before the NSA intended to issue a final request for proposals for a signals intelligence modeling and simulation services contract called Optimal Decision.

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While dozens of firms provide signals intelligence services, the DOJ alleges that Booz Allen and EverWatch are the only two firms planning to compete as prime contractors for the Optimal Decision contract and, thus, the transaction creates a merger to monopoly.

Since the contract is for a so-called three-letter agency, the DOJ alleges that security clearances further limited the competitive field.

Additionally, the DOJ's allegations emphasize EverWatch's role as an emerging competitor with an aggressive and disruptive business strategy. The DOJ characterizes EverWatch an agile and innovative contractor targeting incumbent prime contractors and alleges that it hired several key individuals from

Booz Allen to try to unseat Booz Allen — the 20-year incumbent.[2]

DOJ Is Seeking Faster Access to the Courts

The DOJ moved extremely quickly to file suit — well before the parties could close the transaction. The DOJ noted that it had issued a second request and that the parties have not yet substantially complied.[3]

Although the DOJ is seeking a preliminary injunction, the motion is distinctive in that it seeks to nullify the parties' merger agreement itself rather than to prevent the parties from consummating the transaction under that agreement.

The DOJ filed suit because it believed there was already ongoing competitive harm under the circumstances of this case, namely the imminent NSA request for proposals.

The DOJ's actions in this case follow earlier remarks from Doha Mekki, a senior Antitrust Division official, noting that the DOJ would seek faster access to the courts by filing a complaint prior to compliance with a second request for transactions that it believes are clearly problematic.[4]

DOJ Asserts the Merger Agreement Itself Violates Sherman Act Section 1

The DOJ claims the parties have already violated Section 1 of the Sherman Act by entering into their merger agreement, which is a unique and aggressive approach.[5]

In typical merger challenges, the DOJ and the Federal Trade Commission assert that the merger, if completed, would violate Section 7 of the Clayton Act by substantially lessening competition. Here, however, the DOJ claims that Booz Allen and EverWatch violated Section 1 when they signed their merger agreement and anti-competitive effects are occurring now.

The DOJ's Section 1 theory is that because the merging parties are the only competitors for the Optimal Decision contract, the parties' incentives to compete aggressively declined as soon as they signed their agreement. In effect, both contractors could compete less aggressively — and make more profit by winning the award at a higher price — when they knew they were merging and would win in any event.

Notably, Booz Allen and EverWatch did not agree to stop competing; in fact, both contractors reaffirmed their intent to submit a bid to the NSA after signing the merger agreement.

Booz Allen and EverWatch are likely to argue that they still have strong incentives to compete for the Optimal Decision bid because they have no certainty that their deal will close. Indeed, the DOJ has already created significant risk to the deal by seeking to unwind the merger agreement in court. If the deal does not close, then each party will face the prospect of earning no sales or profits from the Optimal Decision contract if it loses the bid.

In addition to the incentives argument, the DOJ complaint notes that the merger agreement "requires EverWatch to seek Booz Allen's approval before entering into any contract with a value of $500,000 or greater."[6]

The DOJ asserts that this provision effectively gives Booz Allen a veto over EverWatch's bid before the transaction closes. Thus, in the DOJ's view, the merger agreement allows Booz Allen to control

EverWatch's bid offering.

The DOJ asked the court for extensive preliminary injunctive relief abrogating the merger agreement and preventing the parties from taking any actions in furtherance of the agreement.

For example, the DOJ requests that the parties shut down access to the data room, cease integration planning and refrain from obtaining financing. In effect, they would have to operate as though the agreement were never entered and return or quarantine information exchanged to date.

The DOJ's Section 1 theory here is novel. Many mergers of competitors reduce their incentive to compete to some degree as the merged company has the ability to recapture some sales that would otherwise be lost to competition. This feature underlies the Gross Upward Pricing Pressure Index analysis the agencies have applied for years. Here, though, the DOJ is applying the concept prior to closing.

If the theory prevails and the DOJ views the mere act of entering into an acquisition agreement as lessening competition, it will create risks beyond this transaction because the changed competitive incentives could apply whenever the merging parties are competitors.

The DOJ may be taking a particularly aggressive approach here due to several unique factors. The Optimal Decision contract is a huge contract with national security implications; the merging parties are allegedly the only two competitors; and the DOJ appears to believe that the parties pursued the merger to avoid competing.

If the DOJ prevails, it will increase risks for parties simply agreeing to an acquisition, even if the transaction ultimately is never completed. All companies exploring mergers should be sensitive to situations where both parties are involved in ongoing competitions.

The underlying concept that a party may compete less aggressively when it has two competitive offerings flows from basic economic theory and is captured in the horizontal merger guidelines.[7] An emboldened DOJ could apply this same basic principle in other cases, potentially seeking abrogation of acquisition agreements.

The risks are especially pronounced for government contractors, who can face potential debarment issues if they violate the Sherman Act.[8] If parties can violate the Sherman Act simply by agreeing to an acquisition, then the mergers and acquisitions risk profile for any company that sells to the government will greatly increase.

DOJ Alleges the Relevant Market Is Limited to a Single Contract

Antitrust laws are designed to protect competition in a line of commerce. In merger cases as well as conduct cases that do not involve per se unlawful conduct, the government traditionally alleges a relevant product market in which it believes the harm will occur to meet the statutory line of commerce language. Indeed, the relevant market definition is often dispositive in the outcome of antitrust litigation.[9]

Here, the DOJ alleges:

> [The sale of signals intelligence modeling and simulation services to NSA through] the OPTIMAL DECISION contract constitutes a relevant product market and line of commerce under Section 1 of the Sherman Act and Section 7 of the Clayton Act. NSA is a sophisticated customer that knows what signals intelligence modeling and simulation services it requires and has specified those services in the upcoming request for proposals for the OPTIMAL DECISION contract. No other reasonably interchangeable substitutes exist for the services that will be required under the OPTIMAL DECISION contract.[10]

This is an extremely narrow market definition. Presumably, there are other firms that have capabilities to supply signals intelligence services.

For example, the complaint notes that the NSA surveyed 14 companies to gauge their interest in competing for Optimal Decision. But, the DOJ alleges that only Booz Allen and EverWatch planned to compete as primes for this particular contract.

Further, the DOJ deployed another novel tack to downplay the significance of market definition by characterizing the relevant market definition as "an analytical tool for understanding the potential anti-competitive effects."[11] The DOJ's approach appears to minimize the importance of market definition as a requirement for finding liability.

Similarly, the DOJ argues in its preliminary injunction motion that the parties' merger agreement has already had actual detrimental effects on competition, and thus an elaborate industry analysis is not technically necessary.[12]

This approach echoes comments by Assistant Attorney General for the Antitrust Division Jonathan Kanter. In a January speech, he said that "market realities should drive the antitrust analysis, not merely market definition" and "the statistic formalism of market definition may not always be the most reliable tool for assessing the potential harms of mergers."[13]

While defining a market as a single contract is not unprecedented, the agencies have not traditionally used that approach in merger complaints. It remains to be seen whether this case is an outlier given the combined Sherman Act Section 1 and Clayton Act Section 7 attack or if it instead signals a shift and the antitrust agencies going forward will challenge acquisitions on the basis of a single contract rather than assessing aggregate competition across a product or service.

If this approach becomes the new normal, parties considering an acquisition will need to engage in more extensive and fact intensive due diligence at the individual request for proposals level to assess their antitrust risk. It will be important not only to consider which firms are broadly competing to supply a product or service, but also to assess which firms have the resources and intent to compete for specific upcoming competitions.

Government contractors should also consider how firms have teamed together in past competitions and which firms have the experience and capabilities to prime the contract.

Takeaways for Mitigating Risk

While we await the outcome of this litigation, there are several important takeaways from this case for government contractors and others looking to manage their antitrust risks.

Parties contemplating mergers should be mindful of situations where the merging parties are competitors for an ongoing or upcoming bid, especially if there are no other identified competitors.

The DOJ's suit against Booz Allen and EverWatch demonstrates that the DOJ may view the merger agreement itself as an antitrust violation when the agreement creates a merger to monopoly in its eyes, and may seek to abrogate the agreement rather than waiting to block completion of the transaction after the HSR clock has run.

This places a premium on identifying those competitive bids early in the assessment process, which is sometimes difficult to do given the limited read-in teams involved in transactions.

Covenants in merger agreements restricting a target's business operations need to be crafted in a way that allows the target to continue its business in the ordinary course without control by the buyer, including bidding for contracts. The DOJ and the FTC may view overly restrictive covenants as Sherman Act violations.

Companies contemplating acquisitions should carefully assess deal-related documents. For deals that are reportable under the HSR Act, the merging parties must submit to the DOJ and the FTC documents analyzing the transaction from the standpoint of markets, market share, competition and competitors. The agencies place great weight on these documents in understanding the parties' motivations for the transaction and how they view competition.

In this respect, the DOJ complaint quoted extensively from the parties' documents, including statements concluding that together the parties had a 100% probability of winning the Optimal Decision contract, and knowing that the request for proposals was imminent, they "agreed to engage on a preemptive sale process."

In aerospace and defense M&A, it is common for the buyer to conduct a pipeline assessment to understand if the seller's business plan should be adjusted to reduce revenues for contracts that are already in the buyer's own forecasts.

Parties should be careful about creating documents suggesting that a transaction will give them a high probability of winning a particular competition or will greatly increase their probability of winning — even if not to 100%. The DOJ and the FTC will use such statements to try to prove that a transaction will allow parties to lock up competition.

Parties should also be sure to document the procompetitive rationale and benefits of a transaction when they create deal-related documents.

Parties need to be prepared for DOJ or the FTC to challenge transactions earlier in the review cycle if the agency identifies clear competitive harm.

It will be interesting to see how the court handles the latest expansive enforcement effort from the Biden antitrust team.

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[1] See United States v. Booz Allen Hamilton Holding Corp. et al., No. 1:22-cv-01603-CCB (D. Md.), Complaint [hereinafter "Complaint"], available at https://www.justice.gov/opa/press-release/file/1516576/download.

[2] Complaint, ¶¶ 40, 41.

[3] United States v. Booz Allen Hamilton Holding Corp. et al., No. 1:22-cv-01603-CCB (D. Md.), Plaintiff's Memorandum in Support of its Emergency Motion for Preliminary Injunction [hereinafter "PI Memo"], p. 4 n. 5.

[4] See McDermott Antitrust Alert, "Heard on Day One of 2022 Antitrust Law Spring Meeting" (April 7, 2022), https://www.antitrustalert.com/2022/04/heard-at-day-one-of-2022-antitrust-law-spring-meeting/.

[5] Complaint, ¶ 60.

[6] Complaint, ¶ 51.

[7] See, e.g., Dept. of Justice & Fed. Trade Comm'n, Horizontal Merger Guidelines §13 (noting that a partial acquisition may "blunt the incentive of the acquiring firm to compete aggressively because it shares in the losses thereby inflicted on that rival").

[8] 48 C.F.R. § 9.406-2(a)(2) (government contractor may be debarred for violating federal or state antitrust laws relating to the submission of offers).

[9] ABA Section of Antitrust Law, Antitrust Law Developments (8th ed. 2017), p. 579 ("In many instances, the definition of the relevant market may determine the outcome of the case.").

[10] Complaint, ¶ 31.

[11] Complaint, ¶ 30.

[12] PI Memo, pp. 17-19.

[13] Jonathan Kanter, Remarks on Modernizing Merger Guidelines (Jan. 18, 2022), available at https://www.justice.gov/opa/speech/assistant-attorney-general-jonathan-kanter-delivers-remarks-modernizing-merger-guidelines.